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## Corporate Environmental Accounting and Reporting Expectation Gap: Evidence from India

### Abstract ::

*Accounting of environmental matters has been emerging as an important dimension of corporate accounting and reporting practices. In many countries, the disclosure of environmental information has been made mandatory. Companies, all over the world, have also started reporting on the matter voluntarily. In the wake of growing legal and social pressures, many companies in India have also made attempts to disclose their concern for the environment in the annual reports or by some other mediums like environmental statements or Internet. But, in the absence of any specific law, accounting standard or guideline on the issue, these disclosures are subjective, inconsistent, and mainly descriptive and positive in nature. In fact, recent research on corporate environmental reporting has shown that environmental reporting in India is typically deficient and not of a standard to satisfy the information needs of various classes of report users.*

### Environmental Reporting ::

Environmental reporting means incorporation of environmental issues into, the annual reports or other statements prepared by corporate entities. It covers the preparation and presentation of information by the management on the environmental activities and performance of a company, for the use of various stakeholders. In the study, environmental reporting has been taken as the disclosure of environment-related information by a company regarding environmental risks, impacts, policies, strategies, targets, costs and liabilities to those who have an interest in such information. This information may be reported through the annual report; a- stand-alone corporate environmental report (CER); an environmental statement or some other medium like, video, Internet or staff newsletter.

As mentioned earlier, companies all over the world, are under increasing pressure from the green lobby and regulatory authorities to disclose more environmental information. Recent surveys have shown that a large number of companies (particularly multinational corporations) have already started reporting on the environmental issues. As various stakeholders (including investors, creditors and government) demand greater disclosure of a company's environmental impacts and resulting liabilities, companies will have to take care of this aspect of disclosure more seriously. This paper presents environmental disclosure practices of large manufacturing companies in India as reported by their chief executives. The opinions of the respondents on various issues relating to environmental reporting have also been given here.

### General Issues:

As observed before, though environmental concerns have been heightened in recent years, very few countries have specific financial reporting requirements on environmental disclosures. In the absence of any standard or legal requirements on the issue, many companies do not report on environmental matters. Even those who report on the issue do not follow a particular form and thus, there is no consistency in this reporting. This sub-section presents opinions of the CAs and the executives on some general issues relating to environmental reporting.

### 1. Uses of Environmental Information:

These days, most of the big companies develop internal reporting system to capture the cost effects associated with the adoption of environmental friendly business; practices and also the resulting benefits. Companies can generate environmental performance reports for internal decision-making.

Moreover, the external environmental reporting can be used to convey the relevant information on environment to a wider audience. In this part, the relevant uses of environmental information have been analyzed.

A large majority of the CAs were of the view that environmental information should be used for both the purposes. They felt that this information is required by management in making various business decisions (e.g. capital budgeting decisions and estimation of cost of production). Use of this information by management will make them conscious about environmental concerns. It will not only help a company in complying with environmental laws, but at the same time, will encourage voluntary reporting also. For supporting external reporting of environmental information the respondents again gave various reasons like 'it is a part of good corporate governance practice'; 'this information is required by external stakeholders for decision-making'; 'required for global businesses and 'will make accounts transparent'. Only five CAs felt that information should be used for internal decision-making only mainly because external stakeholders are not interested in these figures. On the other hand, eight CAs argued that external reporting of this information is more important and should be given more emphasis.

Regarding actual practices, majority of the companies (75percent) used environmental information produced by them for both the purposes, i.e., internal decision-making as well as external reporting purposes. 22 executives stated that their companies used most of this information mainly for managerial decision-making purposes and only legally required information was reported to outsiders.

## **2. Non—disclosure of Negative:**

**Environmental Information:** It is a common belief that companies operating in environmentally sensitive areas do not disclose environmental information voluntarily, particularly bad news; because the disclosure may jeopardize confidentiality in the sensitive areas and thereby, may adversely, affect competitive position of the company. About 64 percent of the CAs agreed with this belief. They felt that fear of action from regulatory authorities and of misuse of information by competitors compel companies not to disclose information on their environmental impacts (particularly negative information). 34CAs did not consider it to be the most pertinent reason for non-disclosure of environmental information. They were of the view that there are other important reasons also like 'non-sensitivity towards environmental issues', 'lack of top-management's commitment', 'voluntary nature of environmental reporting' and 'absence of accounting guidelines and standards on the issue.'

About three-fifths of the executives felt that the fear of negative publicity is one of the main reasons for non-disclosure of negative environmental information. They were of the opinion that disclosure of bad news (like, oil spills, gas leak, adverse impact on environment) may lead to governmental action and criticism from the public and competitors can take advantage of this. It affects confidentiality in the sensitive areas and may affect competitive position of the company. About 36 percent of the executives were of the view that though this may be one of the reasons for non-disclosure in highly polluting industries; in general, companies do not disclose environmental information because of various other reasons like 'it is not mandatory', 'general public has no interest in environmental figures' or 'lack of accounting standards or guidelines'.

## **3. Making Environmental Information Disclosure Mandatory:**

Disclosure of environmental information (exception energy conservation) is not mandatory in India. A review of the existing studies on environmental disclosure practices of Indian companies reveals that in the absence of any accounting standard or legal compulsion, both quality and quantity of environmental reporting has been quite limited. The executives in the study also informed that their companies didn't prepare environmental accounts mainly because it was not required by law. The respondents were asked whether disclosure of environmental information should be made mandatory in India.

About 90 percent of the CAs and 76 percent of the executives were of the opinion that environmental information disclosure should be made mandatory in India. Most of them believed that companies in India are not self-disciplined and very rarely do things voluntarily. Making environmental reporting mandatory will compel these companies to reduce their adverse environmental impacts because they have to report their environmental activities to the public. It will also improve quantity

and quality of information reported by the concerns. It will make companies environmentally conscious and will encourage eco-efficiency. If a company has to report its environmental activities or performance to the relevant stakeholders under legal compulsion, the company will definitely try to perform better.

However about 24 percent of the executives were against making environmental reporting mandatory. They felt that as long as a company is taking good care of environment, reporting or non-reporting on it does not matter. Making environmental information disclosure compulsory will unnecessarily lengthen the annual reports, will increase expenditure and lead to wastage of time, cost and energy. Therefore, only voluntary disclosures should be there. Two senior managers suggested, in the initial years reporting of some important environmental information items should be made mandatory, that too only for most polluting industries. For other companies, it should only be recommendatory. Later on, in phases, some more items can be selected for mandatory environmental reporting. Moreover, some more companies can be asked to report compulsorily on environment”.

### Place and Type of Environmental Disclosures:

As noted above, majority of the respondents think that a company should disclose information on its environmental activities and performance. This sub-section presents their views on the appropriate place where environmental information should be disclosed and type of environmental information to be disclosed.

**1. Place of Disclosure:** Environmental information can be disclosed in the annual reports or by some other medium like environmental statements or web-sites. However, annual report is generally considered to be the most appropriate place for reporting this information because, firstly, it has wider audience and secondly, the information given in annual report is verified by auditors. •In the annual report also, this information can be disclosed at various places like in the main body of financial statements, footnotes or in Directors’ Report. About 49 percent of the CAs was in favour of disclosure of environmental information in Director’s Report or its annexure. Almost same proportion of the CAs supported disclosure of this information in ‘separate environmental section’ in the annual report. Only 13 CAs felt that this information should be communicated in the main body of financial statements, i.e., Profit. & Loss Account or Balance Sheet. These CAs were asked about advantages of disclosing environmental information at this place. They gave two main reasons for their views. Firstly, if the concept of environmental accounting is to be followed seriously, the information on environmental costs, benefits, assets and liabilities should be disclosed in Profit & Loss Account and Balance Sheet. In this way, the matter of environmental accounting will receive due importance. Secondly, disclosure of this information in the financial statements helps in examining the impact of environmental performance on trading results and financial position of the company. This facilitates decision-making by various stakeholders.

Those CAs who were of the opinion that environmental information should not be disclosed in the financial statements also cited various reasons for their viewpoint, Most of them felt that separate disclosure of this information either in the annual report or stand-alone environmental reports will be more beneficial for the interested stakeholders. It will also highlight importance of this information. Other reasons advanced by some of them were, ‘difficulty in measurement’, ‘lack of accounting standards or guidelines’ and ‘will make annual report bulky’. following summarizes views of the CAs on the issue.

### Disclosure of Environmental Information in the Main Financial Statements: CAs views

Reasons		Number of CAs
<b>A.</b>	<b>For Disclosing</b>	
	Increases seriousness in the issue	3
	Helps in checking its impact on trading results and financial position	8
	Will be verified by auditors	3
<b>B.</b>	<b>For not Disclosing</b>	
	Difficulty in measurement	7
	Lack of accounting standards	5
	Will make annual report bulky	17
	Not required by law	4

	Separate disclosure more beneficial	30
	Will lead to confusion	2
	Any Other	13

Above represents practices of the companies regarding place of environmental information disclosure. The Exhibit shows that about 92 percent of the companies disclosed environmental information in the Director's Report. The executives belonging to 20 companies informed that their companies prepared separate environmental statements also. Most of these companies were public sector corporations or large private sector companies operating in polluting industries. Main body of the financial statements footnotes or annexure was not found to be popular modes of disclosing details on environmental issues. Two companies made these disclosures at other places also like through Internet and press releases.

As evident from the Exhibit that only one company disclosed information on environmental issues in the main body of the financial statements. The executives were asked why their companies did not disclose information in the main body of financial statements. They gave various reasons for this practice like 'disclosure in the financial statements does not affect usefulness of information for decision-makers', 'will have no effect on conventional accounting format' and 'not recommended by professional bodies'. Some other reasons given by them were, 'will make financial statements bulky', 'may distort purpose of financial statements', 'may create confusion', 'society does not require it' and 'will lead to window dressing'.

## 2. Type of Information Disclosed:

A company can disclose quantitative information on environment, e.g. information on environmental costs, benefits, assets or liabilities. Similarly, qualitative details on environmental policies and practices of a company can be reported by management. This part seeks to record opinions of the CAs on the type of information which a company should disclose. The actual practices of the companies regarding this have also been examined. Exhibit presents comparative analysis of the responses.

The Exhibit depicts that a large majority of the CAs (91.1 percent) recommended disclosure of qualitative as well as quantitative information on environmental issues by a company. Only a negligible number favored disclosure of only qualitative or only quantitative information mainly to save time and resources of the company.

### Type of Environmental Information Disclosed

Number (Percent)

Particulars	CA's Opinions	Actual Practices
Qualitative only	1 (1.0)	52 (51.5)
Quantitative only	5 (5.0)	2 (2.0)
Both	92 (91.1)	38 (37.6)
N.A.	3 (3.0)	9 (9.0)
Total	101 (100)	101 (100)

Note: N.A. Not Answered

However, more than one-half of the executives informed that their companies disclosed only qualitative details about environmental policies, systems and practices of the company. The annual reports of these companies mainly included information on 'energy conservation' as required to be disclosed under provisions of the Indian Companies Act. This shows existence of a significant environmental reporting expectation gap in India. Though users want information on both qualitative and quantitative aspects, most of the companies give only descriptive information on the issue. Only about 38 percent of the responding executives claimed that their companies disclosed quantitative as well as qualitative information.

## 3 Qualitative Characteristics of Environmental Information:

Qualitative characteristics are very important for the overall credibility of reporting. Reporting on the nature of environmental impacts means that in order to make the processes of measurement and reporting feasible and credible, certain underlying assumptions may need to be made about either the reporting enterprise or the data being reported. Most of the underlying assumptions and qualitative characteristics of financial reporting are equally applicable to environmental reporting also. For making environmental report useful for external stakeholders, it must also possess certain characteristics like it should be relevant, reliable and understandable. There is a need to present data in as uniform manner as possible, if it is to be of any significant use to external shareholders. However, application of some characteristics is a bit complex in environmental reporting. For example, the application of materiality concept in case of environmental reporting is heavily dependent on the carrying capacity of the receiving environment (such as availability of landfill capacity or background air pollution levels). Moreover, environmental reports may contain some information, which cannot be objectively determined or physically quantified, e.g., environmental impact of company's activities and long-term sustainability. Accordingly, some qualitative characteristics may have to be modified. The standard setters should make adequate provisions accordingly while setting conceptual framework for environmental reporting.

The respondents were asked about their opinions on the qualitative characteristics that must be possessed by the reported environmental information to make it more beneficial for the users. 'Useful in decision-making' was considered as the most important characteristics of environmental information by about 35 percent of the CAs. According to them, there is no use of giving any information in the annual reports or by some other medium, unless it is useful to the stakeholders in making various financial or other decisions. Therefore, only material and significant information that facilitate decision-making should be supplied by a company. Objectivity was another characteristic considered important by them. Till date, in the absence of any accounting standard or guideline on the issue, the environmental information given in the annual report by companies has been generally subjective (e.g., only positive or good information is generally given). In order to make environmental information more useful for the interested external stakeholders, it should be objective. Other characteristics considered as the most important by some of them were relevance, reliability, understandability and completeness. Some CAs felt that all these characteristics are equally important as there is an overlapping in some of these characteristics. For example, in order to be useful in decision-making, information is to be relevant, reliable, objective and complete.

Majority of the executives (55.4 percent) were also of the view that environmental information supplied by a company should be useful in decision-making. Most of them felt that in order to make this information valuable for the stakeholders, it is essential that only relevant and objective information is provided to them. Other important characteristics most preferred by about 45 percent of the executives were understandability, consistency, completeness and reliability. Again some managers were of the view that all these characteristics are important and must be taken care of while preparing environmental reports.

It is to be noted that least important characteristics according to the qualified respondents were timeliness and comparability. They were of the opinion that sometimes it may not be possible for a company to give timely details on environmental issues, as it is difficult to measure its impact in particular time frame. Moreover, in some circumstances, it may become relevant later on due to changes in legislation or otherwise. Similarly, environmental information given by various companies may vary due to differences in their product, process, technology, design or legal requirements for various industries. Thus, certain features of environmental disclosures made by them cannot be compared.

**Cost-effectiveness of Environmental Information:** A company before undertaking any activity generally conducts cost-benefit analysis. Most often, this is one of the bases for making many important decisions. The cost-benefit principle says that cost of applying something should not exceed its benefit. In financial reporting also one of the pervasive constraints is that the benefit to be gained from providing information should be greater than the cost of providing it.

Majority of the CAs (80.2 percent) agreed that the benefits of providing environmental information should be more than the cost involved in it. In their opinion, a formal cost-benefit analysis will help a company in justifying its decision relating to provision of environmental information to stakeholders. Some of them clarified, "It does not mean that to save cost, no or very little information should be given to the users. A certain minimum level of information absolutely essential in decision-making

should be provided". 20 CAs were of the opinion that in providing environmental information, this kind of cost-benefit analysis should not be done. They gave two main reasons for their viewpoint. Firstly, disclosure of environmental information is a part of social responsibility of a company and in these matters, cost factor should not be considered. Secondly, in case of environmental issues, though cost of doing something is generally tangible, most of the times, the benefits are intangible (e.g., enhanced image due to environmental reporting). Moreover, cost of not taking an action (e.g., loss of goodwill due to non-disclosure of environmental information) is also generally difficult to measure. It is, therefore, not feasible to conduct this kind of analysis.

About seven-tenths of the executives informed that the benefits of environmental information to the potential users are generally greater than the cost of providing such information. They told that these days most of the companies prepare environmental statements for internal decision-making purposes. Since this information is already available in the organization, its reporting to the external stakeholders does not involve much cost. On the other hand, various stakeholders (including creditors, government and investors) can take benefit of this information in making relevant financial or other decisions. The company is also benefited because of enhanced image, increased sales and reduced pressures from government.

**Users of Environmental Information:** The IASC conceptual framework differentiates between seven user groups, but is based upon a primary assumption that the needs of financial investors are pre-eminent, and that if their needs are met, then the needs of most other users should be at least partially met. There are various stakeholders like investors, creditors, government and society at large who are interested in environmental disclosure made by a company. United Nations working Group of Experts, ISAR identified various users of environmental information like shareholders/prospective owners, internal line managers, local/regulatory authorities or environmental organizations. These users generally have varying information needs. A company has to identify its relevant users and accordingly decide about the type and nature of environmental information to be disclosed. This also affects the mode by which this information is to be reported and the place where it is to be disclosed (e.g., generally, information to government is given in statutory forms and to shareholders in the annual reports). In this part, the CAs and the executives were asked to rank the given users of environmental information in order of importance.

'Society at large' was considered as the most relevant user of environmental information by about 58 percent of the CAs. 'Government' and 'Environmental Organizations/NGOs' were two other users considered important by them. These CAs were of the opinion that environmental information is mainly useful for the society at large. All the constituents of society need the details on environmental performance of an organization because all of us are a part of environment and in one way or the other, are affected by it. Thus, this information should be directed to a wider audience. In addition, specific purpose statements can be prepared to meet specific need so some segments of the society. It is to be noted that significant percentage of the CAs (more than three-fifth) did not consider suppliers, competitors, customers and journalists to be the relevant users of this information (they gave zero ranks to these users).

About three-fourths of the executives considered 'government' as the most important user of environmental information. One of the manager informed, "Generally environmental information is published to demonstrate to the regulatory authorities that the company is complying with environmental laws and also taking voluntary steps to protect the environment. Most of the times, company is legally required to submit these details to the government. Environmental reporting helps in releasing pressures from regulatory authorities. Hence, government/regulatory authorities are the most important users of environmental information". Society at large and environmental organizations (NGOs) were two more users considered important (given one of the first three ranks) by more than 65 percent of the respondents. According to them, environmental reporting helps to build the trust of the local community. It makes it easier for company to operate and expand. Furthermore, in recent years, non-governmental organizations have become quite active towards environmental problems and many a times their efforts lead to judicial action. The least important users according to the executives were competitors. Suppliers and customers. Some companies informed about other users also like foreign institutional investors.

## **Summary and Conclusions**

The main objective of this paper waste examines existence of an environmental accounting and

reporting (EAR) expectation gaping India. For this purpose, opinions of the selected Chartered accountants were obtained regarding their expectations about corporate environmental accounting and reporting in India in addition, the actual EAR` practices of the selected large manufacturing companies operating in India were analyzed with the help of primary data to examine whether they fulfill expectations of the users of environmental information.

-The CAs, in general, recommended that a company should use environmental information for both internal decision-making and external reporting. They also felt that companies must disclose qualitative as well as quantitative information on these issues. Most of them preferred disclosure of this information in separate environmental statements to 'highlight its importance' and to 'avoid any confusion'. Furthermore, they also approved disclosure of qualitative information in the 'Director's Report'.

A large majority of the CAs were in favor of mandatory disclosure of environmental information. About three-fourths of the executives were also -of the same view. It seems that compulsory environmental information disclosures will increase seriousness in the issue` and will lead to overall increase in environmental reporting by Indian companies. The findings of the study revealed that la large majority of the CAs favored verification of environmental statements prepared by a company mainly to 'increase credibility of information provided' in them. They felt that this audit would also help a company in complying. With environmental laws. The responding CAs felt that a company should submit its environmental report to independent scrutiny mainly to underpin the credibility of the environmental report.

The findings of the study reveal that the respondents were convinced by the need for having an EAR system in the large companies in India. No significant difference was found between the views of users and the preparers on various issues raised in the study. Both the CAs and the executives found usefulness of environmental information in strategic decision-making. They felt that benefits of providing environmental information to the relevant users are more than cost of providing this information. The CAs and the executivesfavoured mandatory environmental reporting in India. But when actual EAR practices (as reported by the executives) were analyzed, significant differences were found in expectations of the users and actual practices of the companies. Though, a large majority of CAs felt that companies must adopt environmental accounting system, only a negligible number of companies were found to be preparing these accounts for external reporting purposes. The users preferred separate environmental statements and Directors reports for disclosing qualitative as well as quantitative information on environment. However, most of the companies had the practice of disclosing only qualitative environmental information in the annual reports mainly through the Director's Report. Indian companies failed to provide adequate disclosures of their environment activities and performance. The evidence is consistent with the existence of an environmental accounting and reporting (EAR) expectation gap within India.

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